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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
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Refer Reply To:
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PLR-108117-07

Date:
May 31, 2007

Distributing =

Controlled =

Q1 =

Q2 =

Q3 =

DE LLC =

State X =

Trust =

Settlor =

Business 1 =

Business 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Dear :

This letter responds to your February 12, 2007, request for rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondences dated March 20, 2007, April 4, 2007, April 25, 2007, May 16, 2007, May 23, 2007, and May 30, 2007, is summarized below. Unless otherwise indicated, references herein to code sections and regulations sections are to the applicable Internal Revenue Code and Income Tax Regulations.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

In particular, this office has not reviewed any information pertaining to, and has made no determination regarding, whether the distribution (defined below): (i) satisfies the business purpose requirement of § 1.355-2(b), (ii) is being used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both (see section 355(a)(1)(B) and § 1.355-2(d)), or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest in Distributing or Controlled (see § 355(e) and § 1.355-7).

Facts

Distributing was incorporated as a State X corporation on Date 1. Distributing has a single class of voting common stock. Distributing's sole shareholder as of Date 2 was Trust. Trust was originally established as a grantor trust by Settlor. Upon Settlor's death, the income beneficiary of the Trust became Settlor's surviving spouse, who is entitled to receive all of the income of the Trust during life, and as much of the principal as the trustees of the Trust deem necessary for support, comfort, and welfare.

Controlled, formerly Q1, was incorporated as a State X corporation on Date 3. As of Date 2, Distributing held all shares of Controlled's outstanding common stock. Controlled is presently a qualified subchapter S subsidiary ("QSub") of Distributing. For at least the last five years, Controlled, as Q1, has operated Business 2.

Q2 was organized by Distributing as a corporation on Date 4. From Date 6 through Date 8, Q2 was a QSub of Distributing. During that period, Q2 operated Business 2.

Q3 was organized by Controlled as a corporation on Date 5. On Date 7, Q3 organized a State X limited liability company, DE LLC, which became a disregarded entity for federal income tax purposes. DE LLC acquired retail operations related to Business 2. From Date 6 through Date 8, Q3 was a QSub of Distributing. During that period, Q3 operated Business 2.

Effective Date 8, Q2 and Q3, both of which were QSubs of Distributing, were merged into Controlled under applicable state corporate laws. Controlled was the surviving corporation in the merger. Distributing proposes to distribute all the common stock of Controlled to Distributing's sole shareholder, Trust (the distribution). Following the distribution, Trust will own 100 percent of the common stock of Distributing and Controlled. Controlled intends to make an S election under § 1362(a), effective immediately, following the distribution.

The continued success of Business 1 and Business 2 depends on the continued expansion of each. Each business would be better able to expand if it were separated from the other. To effectuate the separation and for what are represented to be valid business reasons, Controlled will exchange its stock for the Business 2 assets, cash related to the reasonable needs of Business 2, and for the cancellation of debt owed to Distributing. Distributing will distribute all of the stock of Controlled to Trust. Thereafter, Controlled will elect to be taxed as a subchapter S corporation on the first available date after the distribution.

The financial information submitted indicates that Business 1 and Business 2 have had gross receipts and operating expenses representing the active conduct of a

trade or business for each of the past five years. Distributing is an accrual method taxpayer filing its returns on a calendar year.

Representations

The taxpayer has made the following representations in connection with the transaction described above:

- (a) Distributing, Controlled, and each of the shareholders will each pay his, her, or its own expenses incurred in connection with the proposed transaction.
- (b) No part of the Controlled stock to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.
- (c) The five years of financial information submitted on behalf of Distributing is representative of Distributing's present operation, and with regard to Distributing, there have been no substantial operational changes since the date of the last financial statements submitted.
- (d) Following the transaction, Distributing will continue, independently and with its separate employees, the active conduct of its business. Following the transaction, Controlled will continue, independently and with its separate employees, the active conduct of the business conducted by Q1, Q2, Q3, and DE LLC.
- (e) The distribution of the stock, or stock and securities, of Controlled is carried out for the corporate business purpose of separating the businesses so each can better accomplish their respective expansion plans. The distribution of the stock of Controlled is motivated, in whole or substantial part, by this corporate business purpose.
- (f) The transaction is not used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.
- (g) The cash and investment assets held by Distributing and to be held by Controlled are related to the reasonable needs of the conduct of the active trade or business of each corporation.
- (h) There is no plan or intention to liquidate either Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.

- (i) The liabilities assumed (within the meaning of § 357(d)) in the transaction were incurred in the ordinary course of business and are associated with the assets being transferred.
- (j) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the transaction.
- (k) No investment credit has been (or will be) claimed with respect to the transferred property.
- (l) No intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.
- (m) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (n) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (o) The distribution is not part of a plan or series of related transactions (within the meaning of § 1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50 percent or greater interest (within the meaning of § 355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).
- (p) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the value of the total combined shares of all classes of Distributing stock, that was acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of the distribution.
- (q) For purposes of § 355(d), immediately after the distribution, no person (determined after applying § 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the value of the total combined shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of distribution, or (ii) attributable to distributions on Distributing stock that was

acquired by purchase (as defined in §§ 355(d)(5) and (8)) during the five-year period (determined after applying § 355(d)(6)) ending on the date of distribution.

- (r) The total adjusted bases and the fair market value of the assets transferred to Controlled will each equal or exceed the sum of: (i) the amount of any liabilities assumed (as determined under § 357(d)) by Controlled in connection with the exchange and (ii) the amount of any liabilities owed to Controlled by Distributing (if any) that are discharged or extinguished in connection with the exchange.
- (s) Immediately after the transaction (as defined in § 355(g)(4)), either (1) if any person holds a 50-percent or greater interest (within the meaning of § 355(g)(3)) in any disqualified investment corporation (within the meaning of § 355(g)(2)), such person will have held such interest in such corporation immediately before the transaction, or (2) neither Distributing nor Controlled will be a disqualified investment corporation (within the meaning of § 355(g)(2)).

Rulings

Based solely on the information submitted and on the representations set forth above, we rule as follows with respect to the proposed transaction:

- (1) The merger of Q2 and Q3 into Controlled under applicable state corporate law as of Date 8, will be disregarded for federal tax purposes, and Controlled, as the surviving corporation, will retain its status as a QSub of Distributing (§ 1361(b)(3)(A) and (B)).
- (2) Upon Distributing's distribution of the common stock of Controlled to Trust, Controlled will be treated as a new corporation acquiring all of its assets and assuming all of its liabilities from Distributing immediately before the termination of Controlled's QSub election in exchange for the Controlled stock (§ 1361(b)(3)(B) and (C)).
- (3) The transfer by Distributing to Controlled of its assets in exchange for all of the Controlled stock and assumption of liabilities followed by the distribution of all the Controlled stock to Trust will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (4) Distributing will recognize no gain or loss upon the transfer of property to Controlled in exchange for Controlled stock (§§ 357(a) and 361(a)).

- (5) Controlled will recognize no gain or loss on the receipt of property in exchange for Controlled stock (§ 1032(a)).
- (6) Controlled's basis in each asset received from Distributing will equal the basis of such asset in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (7) Controlled's holding period of each asset received from Distributing will include the period during which Distributing held such asset (§ 1223(2)).
- (8) Trust will recognize no gain or loss (and no amount will otherwise be included in the income of Trust) upon receipt of the Controlled stock (§ 355(a)).
- (9) Distributing will recognize no gain or loss on the distribution of the Controlled stock to Trust (§ 361(c)).
- (10) The aggregate basis of the Distributing stock and the Controlled stock in the hands of Trust immediately after the distribution will equal Shareholder's aggregate basis in the Distributing stock held immediately before the distribution. Such aggregate basis will be allocated between the Distributing stock and the Controlled stock in proportion to the fair market value of each in accordance with § 1.358-2(a)(2) (§ 358(b) and (c)).
- (11) The holding period of the Controlled stock received by Trust will include the holding period of the Distributing stock on which the distribution is made, provided such stock is held as a capital asset on the date of the distribution (§ 1223(1)).
- (12) Distributing's earnings and profits will be allocated between Distributing and Controlled in accordance with § 312(h) and § 1.312-10(a).
- (13) The distribution of Controlled to Trust will terminate the QSub election with respect to Controlled (§ 1361(b)(3)(B) and § 1361-5(a)(1)(iii)).
- (14) Controlled may, without requesting the Commissioner's consent, make an S election before the expiration of the five-year period described in § 1361(b)(3)(D) and Treas. Reg. § 1361-5(c)(1), provided that: (i) immediately following the termination, Controlled is otherwise eligible to make an S election; and (ii) the election is made effective immediately following the termination of the QSub election (§ 1.1361-5(c)(2)).

Caveats

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed regarding: (i) whether the distribution satisfies the business purpose requirement of § 1.355-2(b); (ii) whether the transaction is used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both; and (iii) whether the distribution and any acquisition or acquisitions are part of a plan (or series of related transactions) under § 355(e)(2)(A)(ii). Further, no opinion is expressed concerning whether Distributing's S election is valid; whether Controlled is otherwise eligible to be taxed as an S corporation; and whether Controlled's election to be an S corporation will be valid under § 1362(a).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Debra Carlisle

Debra Carlisle
Chief, Branch 5
Office of Associate Chief Counsel
(Corporate)